

# **REPORT TO THE CITY COUNCIL BY THE CITY INTERNAL AUDITOR**

## **AUDIT OF THE DEBT SERVICE FUND AND DEBT MANAGEMENT FOR THE CITY OF SHREVEPORT**

**INTERNAL AUDIT REPORT 180209-07**

**December 31, 2009**



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Councilwoman Joyce Bowman  
Chairman, Shreveport City Council

Dear Councilwoman Bowman:

Subject: IAR 180209-07 - Audit of the Debt Service Fund and Debt Management for the City of Shreveport

Attached please find the report mentioned above. Management comments are included in the report.

Sincerely,

Leanis L. Graham, CPA, CIA  
City Internal Auditor

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# EXECUTIVE SUMMARY

## AUDIT OF THE

### DEBT SERVICE FUND AND DEBT MANAGEMENT

### FOR THE CITY OF SHREVEPORT

### INTERNAL AUDIT REPORT (IAR) 180209-07

The purpose of the executive summary is to convey in capsule form the significant issues of the audit report. The executive summary is a vehicle for reviewing the report and should only be used in conjunction with the entire report.

## **INTRODUCTION**

Debt financing is a tool local governments can use to meet major capital needs. The Debt Service Fund budget provides for the payment of all interest and principal due on the City's existing General Obligation Bonds (GOBs). The primary source of revenue for this fund is a 26.56 mill property tax dedicated for debt service. In addition to GOBs, the City also has other types of tax-supported debt including certificates of indebtedness, loans, revenue bonds, etc. The primary distinction in the types of debts issued is the type of pledged security – what the issuer provides as guarantee of repayment. The security can be the power to levy taxes, specific revenues, or the property being financed to guarantee its promise to repay the debt with interest.

## **RECOMMENDATION EVALUATION RISK CRITERIA**

The chart below summarizes the recommendations outlined in the report and our evaluation of risk for the recommendations. We evaluated the importance of each audit recommendation by assigning each a level of risk. The risk levels, as defined in the chart below, were determined based on the possible results for the entity if the recommendation is not implemented. This report has five findings and nine recommendations.

<i><b>Risk Levels</b></i>	<i><b>Recommendations</b></i>
<b>High Risk</b> Possibility of fraud, waste, and abuse of City assets; Interrupted and/or disrupted operations; Entity's mission not being met; Adverse publicity.	No recommendations are applicable.
<b>Medium Risk</b> Possibility of continuing, significant operating inefficiencies and high-level non-compliance issues.	* Debt Management Policies and Procedures (Finding 1) * Long-Term Debt Service Fund Projection/Forecast (Finding 2)
<b>Low Risk</b> Possibility of continuing operating inefficiencies and some low-level non-compliance issues.	* Coordination with Bond Advisors/Financial Consultants to Review Debts (Finding 3) * Legal Debt Restrictions (Finding 4) * Centralized Record Management System (Finding 5)

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## **FINDINGS**

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## **ATTACHMENT**

Typical General Obligation Bond Issuance Process .....	<b>Attachment A</b>
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# **AUDIT OF THE DEBT SERVICE FUND AND DEBT MANAGEMENT FOR THE CITY OF SHREVEPORT INTERNAL AUDIT REPORT (IAR) 180209-07**

## **OBJECTIVES**

The objective of this special report is to review the operations of the Debt Service Fund and offer recommendations for improving procedures for managing debt. This was a scheduled audit for 2009.

## **SCOPE AND METHODOLOGY**

Audit procedures included: (1) discussions with appropriate personnel and management, including the Interim Director of Finance, (2) review of applicable documentation and records, (3) research of other debt service funds from similar sized cities, (4) review of GFOA guidelines for debt management, and (5) reviewing debt issuance files for adequacy.

## **BACKGROUND**

The City's debt is largely the product of a number of General Obligation bonds sold over the past twenty years. The most recent debt is the \$70 million issue approved in 2001 for neighborhood improvements, the \$87 million issue approved in 1999 for the Convention Center and Multi-Cultural Center, the \$105 million issue approved in 1996 for various purposes and the \$40 million sold in mid-2005 for the Convention Center Hotel. Much of the debt has been refinanced since its original issue, to take advantage of historically low interest rates. In addition to GOBs, the City also has other types of tax-supported debt including certificates of indebtedness, loans, revenue bonds, etc. The primary distinction in the types of debts issued is the type of pledged security – what the issuer provides as guarantee of repayment. The security can be the power to levy taxes, specific revenues, or the property being financed to guarantee its promise to repay the debt with interest.

## **INTRODUCTION**

General obligation bonds are direct obligations of the City. Principal and interest are payable from ad valorem taxes levied on all taxable property within the City. Certain of the bond issues are currently being paid from sources other than ad valorem tax levies; however, ad valorem taxes are pledged should payment not be made from those other sources.

The proposed 2009 Debt Service Fund budget is \$87.9 million. The City will pay more than \$43.8 million from this fund in 2009 for principal and interest on its General



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Obligation debt. A portion of these costs will be paid from the Riverfront Fund (for Government Plaza and the Section 108 loan for the Entertainment District) and the General Fund (primarily payments on various notes issued to purchase vehicles and heavy equipment). A reserve of \$56.6 million is retained, which is slightly more than one year's debt service.

In addition to General Obligation debt, the City of Shreveport has other types of debts and in various amounts as noted in the chart below (from 2004 to 2008).

	2008	2007	2006	2005	2004
General Obligation Bonds	\$205.4	\$225.4	\$244.9	\$263.5	\$285.5
Certificates of Indebtedness	\$26.8	\$30.7	\$34.4	\$37.9	\$41.1
Loans and Notes	\$33.6	\$32.4	\$33.4	\$34.4	\$35.3
Capital Leases	\$17.4	\$14.4	\$13.4	\$9.8	\$9.9
Airport Revenue Bonds	\$0	\$21.3	\$22	\$22.6	\$23.1
Airport Loan	\$38.2	\$0.85	\$0.85	\$0	\$0
Water and Sewerage Revenue Bonds	\$166.3	\$179.3	\$153.8	\$155.1	\$154.3
Water and Sewerage Loan	\$75	\$75	\$75	\$75	\$0
Convention Hotel Loan	\$39.6	\$42.3	\$42.4	\$42.5	\$1.5
Capital Leases	\$1.5	\$0.6	\$0.84	\$1.1	\$0.1
Total Principal Debt	\$603.8	\$622.25	\$620.99	\$641.9	\$550.8
Interest Requirements	\$219.5	\$243.8	\$252.4	\$278.9	\$204.4
Total Future Debt Requirements	<u>\$823.3</u>	<u>\$866.05</u>	<u>\$873.39</u>	<u>\$920.8</u>	<u>\$755.2</u>

Amounts are in million and rounded up

Source: City of Shreveport Comprehensive Annual Financial Reports 2004-2008

General Obligation Bonds, or full faith and credit bonds, are secure debt with the City's authority to tax and are the least risky for the investors and least expensive for the City to issue. Voter approval is required to issue general obligation bonds. The City has used general obligation bonds for projects such as Convention Center, Street Improvements, Parks and Recreation, etc.

Certificates of Indebtedness are written promissory notes to repay debts on a specified date. The City used them for upgrades in City Hall. They do not require voter approval.

Loans and Notes are debts that do not require voter approval and are not covered by operating revenues for the projects. Independence Stadium Refunding Bonds is one of them.

Leases allow the city the choice to finance vehicles and/or equipment at the lowest cost. Either notes or leases can be used for the same purposes. These are considered short-term and do not require voter approval. The City used them for Capital Lease – Fire trucks and Master Lease Purchase.



Revenue Bonds are limited liability obligations. The revenues to pay for the bonds are provided by specific revenues or fees derived from the projects such as Water and Sewerage, Airport Revenue Bonds. They do not require voter approval.

## **CONCLUSIONS/FINDINGS/ RECOMMENDATIONS**

The Internal Audit Office would like to express our sincere appreciation to the Finance Department management and employees for the courtesy, patience, and for their invaluable assistance and cooperation during the course of our fieldwork and audit. Overall, we found that the Debt Service Fund is being managed adequately. Based on the results of the audit, we believe that an adequate system of internal controls is in existence.

These observations and recommendations were noted during our examination:

### **1. Debt Management Policies and Procedures**

**Criteria:** Establishing policies and procedures over a financial process helps to: promote stability and continuity, standardize responses to situations, educate decision makers without background in financial management regarding the process, and promote long-term thinking. The benefits of having policies and procedures are that they reduce the need for managerial direction of routine matters, improve efficiency through standardization of actions, facilitate the training of personnel, and document institutional knowledge so that operations can continue in the absence of key employees. To be effective, policies and procedures must be in writing so that they are clearly delineated and yet flexible enough to be adaptable to new situations.

**Condition:** The City of Shreveport does not have comprehensive, written debt management policies and procedures concerning: the conditions or purpose/use of debt issued, the process of incurring debt, the type of debt it can issue, or a policy for refunding debt.

The City received a "standard" i.e. average rating in 2007 from the bond ratings Standard and Poors agency, which is a mid-grade/level rating. One of the factors that resulted in the City not receiving the highest bond rating was the City's lack of a formal debt management policy and a general fund minimum reserve policy procedure.

#### **Effect:**

- With no specific policies in place for evaluating it, debt could be issued that is not affordable or cost effective.
- Increased cost of borrowing due to lower bond rating. The ratings are an important factor in determining the interest cost of bonds for the city.



**Cause:**

- The City relies on the State law limits that set the overall debt of Louisiana municipalities to 35% of the assessed value of their property as the primary criteria for issuing and managing debt.
- Decisions about using and structuring debt appear to be driven by the need for individual projects, rather than considered as part of a broad policy that considers capacity now and in the future, limits, and priorities.
- Possible concern that a stated policy would limit flexibility to finance projects of interest or constrain ability to respond to unforeseen circumstances and opportunities.

**Recommendation:** We recommend that the Administration draft debt capacity and management policies for City Council consideration. The policies should:

1. Be integrated with the City's capital planning and budgeting process, including a general fund minimum reserve policy. Although management has stated a 7% general fund reserve policy, this has not been formally adopted by the City Council.
2. Provide for analysis of all debt issues prior to consideration by the city council (e.g., an evaluation of savings related to refinancing activity).
3. Provide for a mechanism for ongoing reporting, monitoring and benchmarking of debt.
4. Include the appropriate ratios and measurements (e.g., per capita, debt service as a percentage of general expenditures) necessary to evaluate the City's credit, as compared with acceptable municipal standards.

**Management Response:** Management concurs and will work with the administration to formulate a set of written policies and procedures concerning the Debt Management for the City of Shreveport.

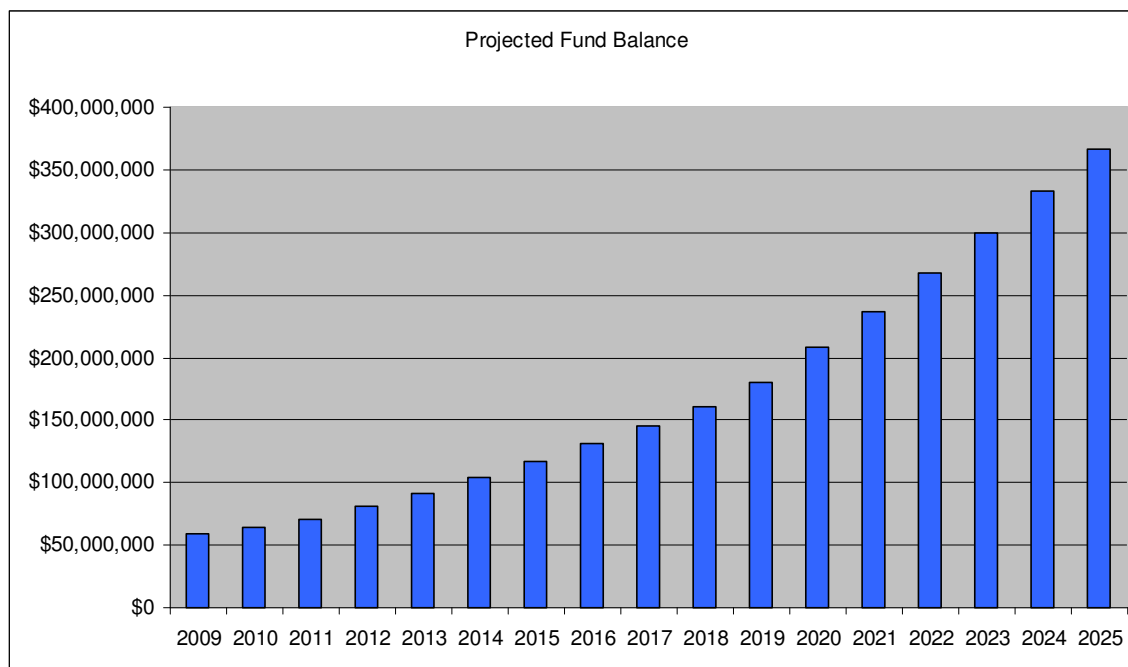
## **2. Long-Term Debt Service Fund Projection/Forecast**

**Background:** The debt service fund accounts primarily for General Obligation bonded debt. A long-term projection for the debt service fund provided by the Accounting Division shows that the fund, with revenue (consisting primarily of a dedicated property tax millage) remaining at its current level and expenditures being paid off at maturity, will have a healthy, growing, and substantial fund balance in future years. Accounting has provided a long-term forecast that shows fund balance growing from about \$59 million in 2009 to about \$367 million in 2025 (see chart following).





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Source: City of Shreveport Accounting Department

**Criteria:** Long-term forecasts and projections help management better plan for future activities, operations, and projects. Ordinance No. 54 of 2009 levies an ad valorem tax "... for the purpose of paying the principal and interest on the outstanding general obligation bonds of the City of Shreveport, and creating a reasonable reserve for the payment of such principal and interest." Additionally, information contained in Attorney General Opinion No. 04-0072 relating to a debt service fund states "... a reserve equal to one year's principal and interest appears reasonable... However, if too great of a reserve is built up, it creates a problem since the city would have to refund the taxes, if practical."

**Condition:** Although a long-term projection has been made for the debt service fund, there are no projections or what-if scenarios for the recommended bond issue proposed or other potential courses of action/expenditures for the projected growing debt service fund balance reserve. Currently, the reserve is more than one year's debt service and is projected to grow steadily over time, as shown in the chart above.

**Effect:** Fund balance proceeds may not be used efficiently and effectively.

**Cause:**

- Adequate information not provided regarding long-term forecast to decision makers.
- Lack of communication.

**Recommendation:** We recommend management:



1. Develop long-term forecasts for decision makers regarding the effect on the debt service fund for the proposed bond referendum or any other proposed action or alternatives.
2. Review the debt service fund balance annually to determine if any adjustments are needed to the revenue source. If there is any additional capacity within the tax rate, a determination should be made of what to do with that additional capacity.

**Management Response:** Management concurs that some type of review should be done, but believe that this should be included in the overall Debt Management Policy and Procedure since the reduction of rates or fund balance would affect the ability to issue further debt.

### **3. Coordination with Bond Advisors/Financial Consultants to Review Debt**

**Criteria:** All related actions for new bond issuances require coordination with personnel in the Finance Department, Bond Advisors, Financial Consultants, State Bond Commission, and various City of Shreveport departments, depending on the type of debt issued.

**Condition:** Our fieldwork revealed that responsible personnel in the Finance Department and other city departments were not fully aware of the bond issuance processes and procedures as they related to coordination with the State of Louisiana Bond Commission for approval of the debt. For example, in a recent bond issue, there appeared to be some confusion regarding necessary documents needed for the State Bond Commission, which led to a delay in the bond approval process.

**Effect:**

- New bonds may not be issued in a timely manner.
- Existing state laws and regulations may be violated.

**Cause:**

- Administrative oversight.
- Turnover of key personnel in Finance Department.
- Lack of established workflow processes.

**Recommendation:** We recommend that the interim Finance Department Director take appropriate action to ensure that responsible personnel are aware of policies and procedures for new bond issuances, including who is responsible for generating documentation, reporting, and monitoring of information submitted to the State Bond



Commission. A flowchart similar to that contained in Attachment A could be developed that guides responsible personnel in the activities concerning bond issuances.

**Management Response:** Since there appears to be no formal Policies and Procedures for bond issuance at this time, any and all persons involved in the bond issuance procedure under the new Policies and Procedures to be established would be notified and consulted as required. A flow chart or time-line could be set up with each new issuance to make sure all deadlines and requirements are met.

#### **4. Legal Debt Restrictions**

**Criteria:** In addition to debt restrictions imposed by state laws for general obligation debt, there are other debt restrictions imposed by debt indenture requirements for debt such as revenue bonds. Those indenture requirements provide that for certain types of revenue bond issues, debt coverage be at least a 1:1 ratio when dividing projected revenues by projected expenditures.

**Condition:** State law allows a maximum of 10% of the assessed valuation for bonded debt for any purpose. However, the 10% maximum can be exceeded if the aggregate issued for all purposes does not exceed 35% of the total assessed valuation. The City is within its legal debt margin for general obligation debt as stipulated by state law.

However, we did note that for other types of debt issues, such as revenue bonds for the Water & Sewerage Enterprise Fund, future debt capacity is very limited. Ratios we reviewed indicate that the Water & Sewerage Enterprise Fund has met its maximum debt threshold limitation and cannot issue future debt.

**Effect:** Future bonds issuances may not be in accordance with mission and goal.

**Cause:** Lack of comprehensive debt capacity and threshold limits reporting.

**Recommendation:** For each debt issue, we recommend the Finance Department establish and report a formal and comprehensive analysis of debt capacity and threshold limits. This new analysis should cover these factors:

- Measures of debt burden on the City by type of issue.
- Current debt service fund obligation, if applicable.
- Measures of revenues and expenses by type of issue.
- Maximum debt threshold limitation by type of issue.



**Management Response:** These restrictions would fall under the Policies and Procedures in that if all debt is issued must be in accordance to any restrictions be they imposed by statute or the bond covenants.

## **5. Centralized Record Management System**

**Criteria:** To ensure proper documents keeping and efficient files accessing, a centralized file system should be maintained.

**Condition:** The Finance Department is in the process of changing from the old paper-based filing system to the new online record management system. In the old paper-based system, folders are not in any particular order.

In addition, files are not located in a centralized location.

### **Effect:**

- Possibility of incomplete files.
- Decrease in productivity.
- Existing state laws and regulations may be violated.

### **Cause:**

- Lack of administrative oversight.
- Finance Department is in the process of moving to an online filing system.

**Recommendation:** We recommend that the Finance Department establishes a centralized record management to maintain better efficiency and completeness of debt files and ensure they are arranged in an organized manner.

**Management Response:** All final bond documents are kept in a safe in the Revenue area on the first floor. Access to this area is restricted by lock doors with only Revenue personnel having access unless the access is granted by Revenue personnel. Records are kept in Director of Finance's office but these may or may not be complete and thus are not considered the final bond document.

Prepared by:

Brian Nguyen  
Staff Auditor



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**SEPTEMBER 21, 2009**

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Approved by:

Leanis L. Graham, CPA, CIA  
City Internal Auditor

BN

c: Mayor  
CAO  
City Attorney  
City Council  
Finance Director  
External Auditor